Foreword

Over the last years stock options have become an integral part of the compensation of senior managers in Germany: Originating in the USA in the 1950s, this form of compensation gained increasing popularity among German corporations during the 1990s, so that by today far over 100 German listed companies grant stock option plans to their employees. Based on recent research the average German CEO ("Vorstandsvorsitzender") receives approximately 10% of his salary in form of stock options. The ongoing globalisations of business practises as well as the boom of the Neuer Markt have been key drivers of this development.

Initially, from an economic perspective the increasing importance of stock option plans in the compensation of senior managers has to be welcomed: Assuming that senior managers through their actions have the ability to influence the stock price of their companies, stock options represent a performance based type of pay that improves the incentives to senior managers to create additional shareholder value. However, this perspective often neglects the potential costs created by such an incentive instrument. Several research studies suggest that companies in some cases generate additional costs through the granting of stock options that can exceed the benefits created by their incentive effect.

This is the focus of the work presented here by Florian Wolff: He develops a proprietary model, which sheds insight into the value gap between the costs of stock options to a company and the subjective value these options hold for the receiving senior managers. The starting point for the estimation of the subjective valuation is the Cumulative Prospect Theory as formulated by Kahneman und Tversky, which is applied for the valuation of stock option plans from the perspective of non-diversified managers. Based on this model Florian Wolff is able to make recommendations on the suitable design of stock option plans.

The work by Florian Wolff is innovative and enhances the field of economic research not only in the area of efficiency of stock options as incentive efficient compensation tools, but also with regards to the issue of the subjective valuation of options from a behavioural stand-point. His model therefore is part of the broader current research in behaviour finance and, without hesitation, must be judged to be on par with the most recently published research work in the field. The work is of benefit for the theoretical as well as the empirical minded reader and I hope that it will be appropriately and widely received.

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